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DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

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U.S. POSITION ON INCREASE IN IMF RESOURCES

This memorandum outlines for SIG-IEP consideration a proposed U.S. position for forthcoming discussions of an increase in the resources of the International Monetary Fund. An attached paper provides background on the costs of U.S. participation in an increase in IMF quotas.

I. Introduction

Discussions of an increase in IMF quotas have been under way since early 1981, on a schedule that originally envisaged completion of the discussions by the end of 1983 and implementation of any agreed quota increase by late 1985. The rapid degeneration of the international financial situation during the past few months led to a decision at the IMF Annual Meetings in Toronto in September to advance the target date for completion of the negotiations to spring 1983. During the course of the Toronto discussions, the United States indicated that it would be prepared to support an increase in IMF quotas adequate to meet requirements for IMF balance of payments financing in "normal" circumstances; and also proposed consideration of a new permanent IMF borrowing arrangement, which would supplement the quota increase and would be available to the IMF on a contingency basis to finance drawings on the IMF in extraordinary circumstances.

In informal discussions since September, the U.S. has tested with other major countries figures for an overall IMF quota increase in the range of 25 to 33 percent, combined with a new borrowing arrangement on the order of \$13-17 billion. On assumptions that the U.S. would accept a modest reduction in its quota and voting shares in the IMF and that the U.S. would have to provide about one-fourth of the financing for any new permanent IMF borrowing arrangement, these figures imply total new U.S. funding of the IMF of about \$7 billion, equivalent to about 50 percent of the present U.S. quota in the IMF.

Although most countries continue to prefer a quota increase in the 50-100 percent range, our informal soundings have elicited interest in the borrowing arrangement concept; and it is possible that a firm U.S. Government position in support of figures in these ranges would provide a basis for agreement among the major countries on this package or something very close to it.

Over the past several months, the prospects for country use of IMF resources during the next year or so have increased substantially.

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- Present estimates put the IMF's uncommitted usable resources at about the equivalent of \$22 billion, and undisbursed usable resources at about the equivalent of \$31 billion.
- Against these resources (under pessimistic but not impossible assumptions) and on the basis of current policies, the IMF could be faced with new financing requests by non-industrial countries totaling the equivalent of roughly \$35 billion on a commitment basis by the end of 1983, and with actual disbursements on the order of \$25 billion through 1983.

While demands for IMF financing in these amounts may not actually materialize, it is clear that even on much more conservative assumptions the IMF could face a significant gap between its uncommitted usable resources and requests for new commitments during the course of 1983. Major problems on a disbursement basis are less likely in 1983, given the phasing of the bulk of IMF drawings over three years. Nonetheless, such "cash" as well as commitment problems could arise, and the IMF may need to explore possibilities for transitional short-term financing pending implementation of the increase in resources now under discussion.

The IMF has a central role to play in promoting an orderly resolution of current international debt and financing difficulties, by providing a source of official balance of payments financing while economic adjustment programs take effect and borrowers reduce their net financing requirements to sustainable levels. The United States has made a major effort over the past year and a half to strengthen the IMF's conditionality -- that is, its approach to requiring effective economic and balance of payments adjustment on the part of borrowers. This effort has shown considerable success. We are pressing major problem countries to establish programs with the IMF, both as a source of medium-term financing while adjustment takes hold and as a source of encouragement to private lenders to provide the continued new financing that will be needed during the adjustment period.

It is particularly important in present circumstances that the IMF be in a position to help meet the extraordinary financing and adjustment requirements that are likely over the next 12 to 15 months. Early agreement on an expansion of the IMF's resources would permit greater use of existing resources, if that becomes necessary, in the knowledge that implementation of an adequate replenishment is assured in the reasonably near future.

II. Elements of U.S. Position

Against this background, the following outlines a proposed U.S. position for discussion with other countries in coming weeks. The main points are summarized in an attached table.

A. Scale of New U.S. Financing of IMF. It is recommended that the U.S. indicate that it is prepared to agree to an increase

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in IMF resources involving new U.S. financial commitments of about \$7 billion. This would be approximately equivalent to a 50 percent increase in the present U.S. quota in the IMF; and would permit total new funding for the IMF of around \$35 billion, equivalent to more than 50 percent of present IMF quotas, with precise amounts dependent on the split to be negotiated between quota increases and the proposed permanent borrowing arrangement and on the sharing of U.S. and foreign participation in each.

B. Quota Increase vs. Borrowing Arrangement. The major attractions of a borrowing arrangement, if properly structured, are that it would provide a greater degree of creditor control than would a quota increase alone, dampening demands for use of IMF resources in normal circumstances and providing flexibility for the IMF to meet surges in financing requirements in extraordinary circumstances. A borrowing arrangement is likely also to involve a higher proportion of actual usable resources than a straight quota increase, strengthening the IMF's liquidity, since it would be more heavily concentrated on the stronger countries. The main potential drawbacks are that most countries give first priority to a major expansion in IMF quotas and that a combined quota increase/borrowing arrangement may prove difficult and time-consuming to negotiate. One approach that might simplify the negotiations would be to build the borrowing arrangement into the existing General Arrangements to Borrow (GAB), and this should be explored in the forthcoming discussions.

It is recommended that the United States indicate a firm preference for a combined quota increase and borrowing arrangement, and consider agreeing to a straight increase in quotas only if negotiation of a combination appears likely to complicate or prolong the negotiations in a major way.

C. Enlarged Access to IMF Resources. A current source of liquidity problems for the IMF is that its present policies on "enlarged access," permitting countries to draw up to 150 percent of quota per year or 450 percent over three years, have been applied liberally, creating a serious imbalance between potential demands for IMF financing and the IMF's resource base. When the "enlarged access" provisions were established in the late 1970s, it was envisaged that they would be phased out upon implementation of the quota increase now under discussion -- which would bring maximum country access back to the 165 percent of quota limit that prevailed prior to the "enlarged access" policy.

It is probably not practical or desirable to terminate "enlarged access" in present world economic circumstances. However, modifications in two areas would be desirable to maintain reasonable balance between IMF resources and potential demands on those resources, and to conserve very large-scale IMF financing for use in country cases or circumstances of broad systemic importance. The first would be to adjust the 450 percent of quota limit downward to maintain maximum access in money terms unchanged as a consequence of the quota increase -- i.e., to offset the expansion in nominal access

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that would otherwise take place as a consequence of the quota increase. The second would be to establish a strong presumption that normal access would be substantially smaller than the maximum, with use of the maximum reserved for exceptional cases or circumstances that involve a threat to the international monetary system.

Assuming a quota increase in the range discussed in this paper, and even with modification of the "enlarged access" policies, the IMF may find it necessary to continue to borrow on a short- to medium-term basis from official sources. In addition, there may occur times when market borrowing by the IMF would be an appropriate supplement to its resources. The United States has not opposed market borrowing in principle, but rather has preferred to hold that possibility in reserve. There are also other limitations associated with market borrowing by the IMF. For example, some other major countries are strongly resistant, and the borrowing potential of the IMF in the private markets in any case is likely to offer the possibility of only modest supplements to IMF resources.

It is recommended that the United States insist on modifications of the "enlarged access" provisions along the lines suggested above as part of agreement on the overall package on IMF resources.

D. U.S. Quota and Voting Shares. Quotas determine voting power in the IMF, and the competition for increased shares is strong. The current U.S. quota share is 20.65 percent, and the current U.S. voting share is 19.52 percent, the difference resulting from a small number of unit votes accorded each IMF member country. The United States has traditionally resisted major reductions in its quota and voting shares, in order to maintain its voting share substantially above the veto point (15 percent) for key IMF decisions -- such as amendments to the IMF Articles of Agreement, quota increases, SDR allocations and a number of other major issues.

During the course of the current quota review, we have acknowledged that the traditional quota formulas (based on economic and financial criteria) point to some reduction in the U.S. quota and voting shares. At the same time, we have sought to maintain a substantial cushion above the 15 percent veto point that applies to major decisions, in order to provide protection against gradual erosion of the U.S. quota share over the years and the potentially substantial reductions that could take place in the event of a major expansion of IMF membership in the future. As a very rough guess for illustrative purposes, future accession to IMF membership of Switzerland and non-IMF members in Eastern Europe could mean a 2 1/2 to 3 1/2 percentage point reduction in U.S. voting power, and there are a number of other countries or entities that could eventually become IMF members as well. Thus, while the current U.S. cushion of 4 1/2 percentage points over the veto point may appear substantial at present, it could drop rapidly under some circumstances in the future.

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It is recommended that the United States be prepared to accept a reduction of roughly 1/2 percentage point in its voting share, to around 19 percent, consistent with the quota formulas and to help accommodate share increases desired and merited by others. Such a reduction would be accepted only in the context of similar reductions for other countries for which the quota calculations point to share reductions.

E. Timing. Given the serious deterioration in international financial conditions and the prospect of very heavy recourse to IMF financing during the next year, it is recommended that the United States seek to further advance the target date for agreement on expansion of IMF resources to late 1982 or early 1983, and to establish a target for implementation not later than end-1983. For U.S. participation, this would involve submission of legislation in early 1983 and a major effort to secure Congressional authorization and appropriations to be available in early FY 1984.

F. Other Issues. There are also a number of less critical points that will need to be settled as part of the negotiations on an increase in IMF resources.

1. Access to the Compensatory Financing Facility. It is recommended that access to this relatively unconditional facility (currently a maximum of 125 percent of quota) be maintained constant in nominal terms -- that is, that absolute access to this facility not be permitted to increase, as would otherwise be the case as a consequence of an increase in quotas.

2. Rate of Remuneration Paid to to Creditors. IMF creditors providing resources to the IMF through their quota subscriptions currently earn remuneration (interest) on their advances to the IMF at 85 percent of the SDR interest rate (the SDR interest rate is an average of short-term interest rates in the U.S., U.K., Germany, France and Japan). It is recommended that the U.S. seek agreement that the remuneration rate be raised to 100 percent of the SDR interest rate -- that is, to the full market average.

3. Interest Rates on Loans to the IMF Under Borrowing Arrangement. It is recommended that loans to the IMF under the proposed permanent borrowing arrangement bear interest at rates related to market rates in the major lending countries.

4. Charges on IMF Drawings. At present, charges on IMF drawings financed by the IMF's ordinary quota resources are set at levels designed to assure that the IMF's reserves increase by 3 percent a year. The current charge on ordinary drawings is 6.6 percent. (Average charges are substantially higher, however, because drawings on borrowed resources carry market related rates.) The increase in the rate of remuneration proposed above is likely itself to lead to some increase in the rate of charges on drawings. It is further recommended that the U.S. seek a change in the formula

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for charges, to raise the target level for the increase in IMF reserves from 3 percent per year to a market-related interest rate.

5. Payment of Quota Subscriptions. Twenty-five percent of each country's quota increase is normally to be paid in the form of SDR and 75 percent in the form of local currency. Regarding the 25 percent portion, the IMF Governors can decide (70 percent majority) to permit this payment to be made in local currency also, or in the currencies of specified other countries (with their consent). It is desirable that there be some "hard" payment requirement, both to strengthen the IMF's liquidity and to inhibit demands for excessive quota increases. On the other hand, a requirement of payment in SDRs is certain to create major pressures for an allocation of SDRs to finance the quota payment.

Therefore, it is recommended that the U.S. seek agreement that the 25 percent portion may be paid either in SDRs or in usable foreign currencies specified by the Fund with the consent of the issuing countries.

III. Budgetary and Financial Implications of Increased U.S. Participation in IMF

Under arrangements developed in connection with the most recent U.S. quota increase and U.S. arrangements for lending to the IMF:

- (a) An increase in the U.S. quota and U.S. lending commitments to the IMF require full Congressional authorization and appropriation.
- (b) Transfers of cash to the IMF under either the U.S. quota or U.S. lending commitments do not result in net budget outlays. Each such transfer is recorded as an expenditure, but is offset simultaneously by a receipt (offsetting collection) in the form of an increased U.S. reserve position in the IMF (a liquid, interest-earning asset). Transfers of cash back to the United States receive the reverse treatment.

Cash transfers to and from the IMF do, however, affect the Treasury's cash position and borrowing requirements. Whether there are net costs or gains to the Treasury, and how much, depend on (a) the relationship between Treasury borrowing costs and interest earned by the Treasury on its transfers to the IMF and (b) any exchange gains or losses to the Treasury on U.S. claims on the IMF. Historically, the nets have been small. Moreover, as noted above, it is recommended in this memorandum that the U.S. seek agreement that all advances to the IMF, whether under quotas or loans to the IMF, be made on the basis of market interest rates, which would reduce the possibility of net costs to the United States in the future.

Additional detail on estimation of the financial costs or gains of U.S. participation in an IMF quota increase is attached.

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Summary Elements of
Proposed U.S. Position on
IMF Quotas and Borrowing Arrangement

A. <u>New U.S. Funding for IMF</u>	\$7.0 Billion*
B. <u>Illustrative Division Between Quota Increase</u> <u>And Borrowing Arrangement</u>	\$3.8 Billion
U.S. Quota Increase	\$3.2 Billion
U.S. Participation in Borrowing Arrangement	\$22.2 Billion
Increase in Total IMF Quotas	\$12.6 Billion
Total New Borrowing Arrangement	
C. <u>"Enlarged Access" Policies</u>	Constant in
Maximum limits	Money Terms
"Normal" limits	Substantially
	Less Than
	Maximum
D. <u>U.S. Shares</u>	19.82 Percent
New Quota Share	19.00 Percent
New Voting Share	
E. <u>Timing</u>	Late 1982-
Agreement	Early 1983
Implementation	End 1983
F. <u>Other Issues</u>	Constant in
1. <u>Access to Compensatory Financing Facility</u>	Nominal Terms
2. <u>Rate of Remuneration</u>	100 Percent of
3. <u>Interest on Borrowing Arrangement</u>	SDR Rate
4. <u>Charges on IMF Drawings</u>	Market
5. <u>Payment of Quota Subscription</u>	Raise Formula
	Target for IMF
	Reserve Increase
	25 Percent in
	SDR or Usable
	Foreign Currency
	75 Percent in
	Local Currency

* Dollar figures converted from SDR at rate of SDR=\$1.09.

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Cost of Increase in U.S. Quota in IMF

Questions have been raised about the cost to the United States of an increase in the U.S. quota in the IMF. The cost -- or gain -- to the United States depends on three factors: the rate of actual U.S. cash transfers to the IMF or cash receipts from the IMF under the increased quota; the difference between Treasury borrowing costs and remuneration (interest) received by the Treasury on transfers to the IMF; any exchange gains or losses to the Treasury on the SDR-denominated claims on the IMF that arise from net cash transfers from the U.S. to the IMF. None of these factors is predictable with any precision. But they are likely to result in net costs or gains that are miniscule relative to either the size of the quota increase or total Treasury borrowing costs.

The following outlines the main points.

(a) Any U.S. quota increase is likely to be paid 25 percent in SDR or foreign currency and 75 percent in dollars.* The SDR/foreign currency portion will be paid immediately in cash. The dollar portion will be paid in the form of a letter of credit, which will be drawn down -- or built up -- gradually, depending on the flow of country drawings of dollars from the IMF and repayments of dollars to the IMF. Net drawdowns on the U.S. letter of credit represent U.S. cash transfers to the IMF and an increase in Treasury borrowing requirements; net reconstitution of the U.S. letter of credit represents IMF cash transfers to the U.S. and a decrease in Treasury borrowing requirements. The net has varied widely over the years, resulting in cash outflows from the Treasury in some years, inflows to the Treasury in others; on average, it has been a small proportion of our quota.

(b) Any net U.S. cash payments to the IMF -- whether arising from the 25 percent SDR/foreign currency payment or from drawdowns on the U.S. letter of credit -- earn "remuneration" at a rate currently equal to 85 percent of the SDR interest rate. These earnings need to be balanced against the increase in Treasury costs on borrowings to finance the net transfers to the IMF. The rate of remuneration currently earned by the U.S. is 7.57 percent; the rate paid by the Treasury on the October 18 90-day bill auction was 7.69 percent (yield basis). The U.S. has, in addition, suggested an increase in the remuneration rate to the full SDR interest rate (currently 8.9 percent).

(c) The 25 percent SDR/foreign currency subscription, and any net IMF drawdown on the U.S. letter of credit, give rise to an SDR-denominated U.S. claim on the IMF -- the U.S. "reserve position in the IMF" -- which is available to the United States for drawings of foreign currency or SDR from the IMF in case of balance of payments need. The dollar value of this asset fluctuates with changes in the \$/SDR rate and gives rise to valuation gains and losses that need to be taken into account along with any net interest gains or costs to the Treasury.

*The Board of Governors could authorize the full amount of quota subscriptions to be paid in local currencies.

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The attached table, prepared for use with the Congress in connection with the last U.S. quota increase, indicates that, for the eleven-year period ended April 30, 1980:

-- Treasury debt outstanding attributable to transactions with the IMF averaged \$740 million. This is not an annual increase in Treasury borrowing, but an estimate of the total debt outstanding each year attributable to cumulative U.S. transactions with the IMF.

-- Net interest costs to the Treasury associated with all U.S. transactions with the IMF averaged \$26 million.

-- Net valuation gains to the U.S. on the U.S. reserve position in the IMF averaged \$45 million.

-- The net U.S. gain, taking account of interest and valuation, thus averaged \$19 million.

Developments in the past two years -- including relatively high U.S. interest rates, substantial net IMF drawings on the U.S. quota subscription, and appreciation of the dollar -- have undoubtedly changed these results. Treasury staff is updating the calculations. But, on the basis of the factors involved and past experience, there is no reason to project significant financial costs to the United States as a result of an increase in our IMF quota.

Also attached is a recent Treasury staff paper describing IMF operations and U.S. financial relations with the IMF in some detail.

Treasury/IMA
October 21, 1982

8/29/80

Estimated Profits and Losses on
Transactions Under U.S. Quota in the IMF
(millions of dollars)

Year Ended April 30 1/	(1) Cumulative Net Treasury Borrowing Arising from Transactions Under U.S. Quota in IMF 2/	(2) Borrowing Cost to Finance Column 1 3/	(3) Remuneration Received by U.S. from IMF 4/	(4) Exchange Gains (+) or Losses (-) on U.S. Reserve Position in IMF 5/	(5) Interest Earned by U.S. on Holdings of Foreign Currencies Drawn from IMF 6/	(6) Net Profits (+) or Losses (-) 7/
1970	656.3	- 45.7	+13.1	-	-	- 32.6
1971	598.5	- 33.4	+12.0	-	-	- 21.4
1972	1.0	0 8/	0 8/	-	-	0 8/
1973	-	-	-	+ 33.5	-	+ 33.5
1974	-	-	-	+ 53.9	-	+ 53.9
1975	16.4	- 1.2	+ 0.4	+ 70.2	-	+ 69.4
1976	268.6	- 14.9	+ 9.0	-182.2	-	-188.1
1977	2035.5	- 99.7	+79.4	+ 53.5	-	+ 33.2
1978	2240.8	-127.9	+79.0	+219.1	-	+170.2
1979	1550.7	-123.1	+29.6	+226.7	+ 25.3	+158.5
1980	1174.7	-129.9	-	+ 15.2	+ 46.3	- 68.4
Total		-575.8	+222.5	+489.9	+ 71.6	+208.2

1/ Represents IMF fiscal year.

2/ Includes both U.S. transfers of dollars to the IMF (i.e., an outflow of dollars from Treasury) and dollar balances received by the U.S. from sales of foreign currency drawn by the U.S. from the IMF (i.e., an inflow of dollars to the Treasury).

3/ Equals column 1 times average Treasury 3 month bill rate during period.

4/ Prior to 1975, IMF rate of remuneration was 1.5 percent per annum although special income distributions were made in 1970 and 1971 which raised the effective remuneration to 2.0 percent in those years. From 1975, the rate of remuneration was based on short-term market interest rates in the five largest IMF members (U.S., U.K., Germany, France, Japan).

5/ Reflects changes in the dollar value of the reserve position due to an appreciation (-) or depreciation (+) of the dollar in terms of the SDR.

6/ Interest earned on investments of German marks and Japanese yen acquired from U.S. drawing on IMF in November 1978.

7/ Equal to sum of columns 2 through 5.

8/ Less than \$50,000.